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No. 92-1046

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

NATIONAL UNION FIRE INSURANCE COMPANY
OF PITTSBURGH, PA.,
Petitioner,
v.
JOHN B. CAMP, TRUSTEE,
SECURITIES INVESTOR PROTECTION CORPORATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* OF THE SURETY ASSOCIATION OF AMERICA IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* OF THE SURETY ASSOCIATION OF AMERICA IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Surety Association of America (Amicus) respectfully moves for leave to file the attached brief *amicus curiae* in support of Petitioner's pending Petition for Writ of Certiorari. Amicus fully supports Petitioner's position that its Petition should be granted and that the judgment of the 11th Circuit should be reversed.

The consent of the attorney for petitioner has been obtained.

The consent of the attorney for the respondent was requested but refused.

I. NATURE OF AMICUS INTEREST

The nature of Amicus interest in this case arises from its function as a trade association and insurance rating bureau composed of 635 insurance companies. Since its founding in 1908, Amicus has uninterruptedly served that portion of the insurance industry that develops and markets surety and fidelity bonds by acting as a common agent for its 635 member companies. Through lawful contact with regulators, self-regulating organizations, the public, and the courts, Amicus works to promote a climate in which bonds serve a useful purpose and to assure that bonds are available to the public when requested.

At issue here is a Securities Dealer Blanket Bond issued by Petitioner, an Amicus member. Since 1916 Amicus has cooperatively developed a variety of financial institution fidelity bond forms, such as the type in litigation here, usually in collaboration with industry trade groups representing the purchaser of the contract [e.g., American Bankers Association, United States League of Savings Institutions and National Association of Securities Dealers, Inc. (NASD)] to meet the specific needs of Insureds: The Standard Form 24 for banks, the Standard Form 22 for savings and loan associations; and the Standard Form 14 for stockbrokers and security dealers, among others.

II. SIGNIFICANCE OF THIS LITIGATION

Amicus suggests that the 11th Circuit decision nullifying Section 12(c) of Petitioner's bond providing for its immediate termination upon the taking over of the insured by a receiver or other liquidator in the name of 11 U.S.C. § 541(c)(1)(B) is a case of the first impression, presenting an entirely novel question of law for decision by this Court which cannot be governed by any existing precedent.

A viable market with willing purchasers and providers of fidelity and surety bonds permitting liberty of contract is of vital concern to Amicus. The decision rendered by the 11th Circuit in mistakenly relying on bankruptcy law to reach its decision, severely restricts and impinges upon that liberty and defies and runs counter to accepted principles applicable to the construction of contracts and statutes.

III. POINTS OF LAW TO BE RAISED BY AMICUS NOT RAISED BY THE PARTIES

Amicus wishes to urge two points to this Court, as supportive of the proposition that the 11th Circuit should be reversed and which points Petitioner has not raised, as follows:

POINT I

11 USC § 541(c)(1)(B) HAS NO BEARING ON OR APPLICATION TO THE FIDELITY BOND'S SECTION 12(c) AUTOMATIC TERMINATION PROVISION

A. Termination Of The Bond Did Not And Could Not Prevent Transfer Of Debtor's Interest In Property To The Trustee; Hence, Bond Sec. 12(c) Is Immune To Nullification By 11 U.S.C. § 541(c)(1)(B)

B. As a Congress-Created Insurer, Neither SIPC Nor Its Appointed Liquidator Can Override the Termination Provisions Of A Financial Institution's Fidelity Bond

C. The FDIC Secretary of the Treasury and Attorney General Recognize That 12 U.S.C. § 1821(e)(12)(A) Prevents a Receiver or Conservator From Nullifying the Immediate Termination Provision of a Financial Institution Bond

D. The Accepted Principles of Statutory Construction Support a Reversal of the Lower Court's Holdings

POINT II

MAKING FINANCIAL INSTITUTIONS' D & O POLICIES AND FIDELITY BONDS ALSO COVER THE FINANCIAL FAILURE OF THEIR INSUREDS BY NULLIFYING SELECTED PROVISIONS OF SUCH CONTRACTS CAN ONLY MAGNIFY THE ADVERSE ECONOMIC EFFECTS OF THOSE FAILURES

IV. THE VALUE OF AMICUS TO THESE PROCEEDINGS

The foregoing matters which Amicus wishes to bring to the attention of the Court are especially within the ambit of its expertise.

Amicus suggests to the Court that because of its long-term experience with the surety industry and the bond form at issue here, that it is in an excellent position to inform the Court of interests other than those presented by the parties to this litigation and to aid the Court as it focuses its attention on the broader implications of possible rulings it might render in these proceedings.

Amicus respectfully suggests to this Court, in the strongest terms possible, that the position and perspective suggested by Amicus, if adopted by this Court, will be dispositive of this litigation.

Respectfully submitted,

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Date: January 13, 1993

QUESTIONS PRESENTED

1. Does 11 U.S.C. § 541(c)(1)(B) nullify the termination provision of a financial institution bond even though the termination of that bond cannot prevent any property interest of the debtor from passing to the bankruptcy trustee or estate?

2. Does the specific language of 12 U.S.C. § 1821(e)(12)(A) (1989), which precludes a conservator or receiver from nullifying the termination provisions of a financial institution bond, take precedence over the general power to enforce debtor's contracts granted by 11 U.S.C. § 541(c)(1)(B) (1978)?

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BRIEF *AMICUS CURIAE* OF THE SURETY ASSOCIATION OF AMERICA IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

INTEREST OF *AMICUS CURIAE* [1] THE SURETY ASSOCIATION OF AMERICA

Amicus Curiae, the Surety Association of America (Amicus), organized in 1908, is one of the oldest trade associations and insurance rating bureaus in the United States. It is curently licensed as an advisory or rating organization or is otherwise recognized by all 50 states, the District of Columbia and Puerto Rico. Amicus serves

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[1] Petitioner, National Union Fire Insurance Company of Pittsburgh, Pa., has consented to the filing of this amicus brief. Its letter of consent is on file with the Clerk of Court. Respondent, John B. Camp, Trustee, Securities Investor Protection Corporation, does not consent to the filing of this amicus brief.

that portion of the insurance industry that develops and markets surety and fidelity bonds by acting as a common agent for its 635 member companies. Through lawful contact with regulators, self-regulating organizations, the public, and the courts, Amicus works to promote a climate in which bonds serve a useful purpose and to assure that bonds are available to the public when requested.

In 1916 Amicus and the American Bankers Association drafted a fidelity bond known as the Bankers Blanket Bond, Standard Form No. 1. Since then Amicus has cooperatively developed a variety of similar financial institution fidelity bond forms, usually in collaboration with industry trade groups representing the purchasers of the contract [e.g., American Bankers Association, United States League of Savings Institutions and National Association af Securities Dealers, Inc. (NASD)] to meet the specific needs of Insureds: the Standard Form 24 for banks; the Standard Form 22 for savings and loan associations; and the Standard Form 14 for stockbrokers and securities dealers, among others.[2]

Amicus has a legitimate and urgent interest in this litigation. At issue here is a hybrid of the Standard Form 14 (Form 14), marketed by National Union Fire Insurance Company of Pittsburgh, Pa. (Petitioner)[3] as part of the NASD[4] sponsored Group Fidelity Bond Buy-

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[2] See Appendix A, page 1a, The Surety Association of America Cause of Loss Experience Statement for Combined Coverage Blanket Fidelity Bonds, which lists the financial institutions covered by these products, as well as the uniform coverages provided.

[3] See Appendix D, page 5a, for excerpts from Petitioner's bond relating to coverage, discovery, definition of property and termination.

[4] NASD requires its members to "maintain a fidelity blanket bond" (NASD Rules, ¶ 2182). Securities Investor Protection Corporation (SIPC) requires all brokers to be members of NASD (15 U.S.C. § 78iii). See Appendix F, page 11a, Excerpts from SIPC's Fourth Circuit Brief *In re Waddell Jenmar Securities, Inc.*, which

ing Program,[5] under the name Securities Dealer Blanket Bond.

The 11th Circuit decision nullifying Section 12(c) of Petitioner's bond providing for its immediate termination upon the taking over of the insured by a receiver or other liquidator in the name of 11 U.S.C. § 541 (c)(1)(B) is a case of the first impression, presenting an entirely novel question of law for decision by this Court which cannot be governed by any existing precedent.

A viable market with willing purchasers and providers of fidelity and surety bonds permitting liberty of contract is of vital concern to Amicus.[6] In the words of the court in *Fidelity & Deposit Company of Maryland v. Thomas R. Conner, et al.*, 973 F.2d 1236, 1243 n.16 (5th Cir. Tex. 1992), refusing to permit such termination provisions will "result in a market with few or no providers and little or no affordable coverage." [7]

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recognizes on pages 28 and 29 that there is a requirement that broker-dealers obtain fidelity bonds.

[5] See Appendix H, page 17a, for the December 17, 1982 NASD memorandum announcing this program to its members.

[6] The present market for Form 14 bonds is viable. For instance, in December of 1992, in an informal Amicus poll of the top eight Amicus members (by premium volume) who were providers of fidelity insurance in 1992, it was determined that these eight insurance companies/groups provide fidelity insurance to approximately 4,500 securities dealers. The total current aggregate limit of coverage of these securities dealer bonds is approximtaely $4.16 billion. If the 11th Circuit decision is allowed to stand, that in-force coverage will be exposed to a risk that was neither contracted nor premium-rated for.

[7] For an insight into the view of an Amicus member as to the impact of removing the subject termination language from the bond, see Appendix G, page 14a, January 19, 1990 Letter From Continental Insurance Company to Federal Deposit Insurance Corporation (WDIC) Responding to an FDIC Inquiry.

Amicus is in a unique position to enlighten the Court on these critical issues.

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioner's bond [8] was written on a discovery basis.[9] This means that loss may be sustained at any time, even before the effective date of the bond, provided that the loss is discovered during the bond period, resulting from, among other things, dishonest acts of its employees.[10]

Form 14 [11] was developed by Amicus in 1936 containing the exact termination provision examined by the 11th Circuit in this litigation. That termination provision is found in Section 12(c) of the bond [hereinafter Sec. 12(c)], and provides for the immediate termination of the bond upon the taking over of the insured by a receiver or other liquidator or by state or federal officials.[12] A similar, and in most cases identical, termination provision is found in all financial institution fidelity bonds,

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[8] See Appendix D, page 5a, for pertinent excerpts from Petitioner's bond (National Union Fire Insurance Company of Pittsburgh, PA.'s Securities Dealer Blanket Bond).

[9] *Commercial Property Risk Management and Insurance Volume II*, American Institute for Property and Liability Underwriters, 3rd Ed. (1988).

[10] *In re Government Securities Corp.*, 972 F.2d 328 at 328 (11th Cir. 1992).

[11] See Appendix E, page 8a, for pertinent excerpts from the Amicus Standard Form 14 bond relating to coverage, discovery, definition of property and termination.

[12] The Amicus membership as a whole considers that provision to be a critical component of all financial institution bonds, without which it would be logical that these companies might adopt a more conservative underwriting posture to protect their individual economic interests. See Appendix G, page 14a, January 19, 1990 Letter From Continental Insurance Company to FDIC Responding to FDIC Inquiry.

and has continuously been in the Form 14 bond since 1936.[13]

Petitioner's bond was issued to protect GSC, a securities broker, from losses resulting from dishonest acts and provided in Sec. 12(c) that:

> The bond shall be deemed terminated or canceled as an entirety . . . immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials. . . .

Bond ¶ 12(c) (Exhibit "A" to Trustee's Amended Complaint served September 30, 1988).[14] When SIPC commenced a liquidation of the broker pursuant to the Securities Investor Protection Act of 1970 (SIPA), and made claim on Petitioner under the bond, Petitioner denied bond coverage on the ground that, pursuant to the provisions of Sec. 12(c), the bond terminated upon the appointment of the Trustee to oversee the insured's liquidation. The 11th Circuit affirmed the Bankruptcy Court and the Federal District Court holdings that Bankruptcy Code Section 541(c)(1)(B), which provides that an interest of the debtor in property becomes the property of the estate notwithstanding any provision in an agreement that, among other things is conditioned on taking possession by a custodian before bankruptcy proceedings are commenced, and that "effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property," [15] was "imported" into SIPA and therefore invalidated Petitioner's bond termination clause.

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[13] See Appendix C, page 3a, for excerpts from Fidelity and Deposit Company of Maryland's 1936 Standard Form 14 Revised relating to coverage, discovery, definition of property and termination.

[14] See Appendix D, page 5a, for the complete text of 12(c) of Petitioner's bond.

[15] See Appendix B, page 2a, for the full pertinent text of 11 U.S.C. § 541(c)(1)(B).

The 11th Circuit's holding immediately brings into play:

(1) The specific interest in property (the GSC bond) which 11 U.S.C. § 541(c)(1)(B) targeted and intended to protect:

(2) The fact that GSC's only "interest in property" in the bond was in the pre-paid premium, and in any claims that were discovered and made by GSC prior to May 12, 1987, when SIPC applied to the court for an order placing GSC into SIPA liquidation procedures which immediately terminated the bond, both of which interests in property did not terminate upon termination of the bond;

(3) The fact that Sec. 12(c)'s termination provision is immune from 11 U.S.C. § 541(c)(1)(B);

(4) The true purpose and meaning of 11 U.S.C. § 541(c)(1)(B) of the Bankruptcy Act of 1978 and its relationship to the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) public policy declaration in 12 U.S.C. § 1821(e)(12)(A)[16] that a conservator or receiver may enforce any contract, other than a Director's and Officer's (D & O) liability insurance contract or a depository institution bond;

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[16] See Appendix B, page 2a, for the pertinent text of 12 U.S.C. § 1821(e)(12)(A).

ARGUMENT

POINT I

11 USC § 541(c)(1)(B) HAS NO BEARING ON OR APPLICATION TO THE FIDELITY BOND'S SECTION 12(c) AUTOMATIC TERMINATION PROVISION

A. Termination Of The Bond Did Not And Could Not Prevent Transfer Of Debtor's Interest In Property To The Trustee; Hence, Bond Sec. 12(c) Is Immune To Nullification By 11 U.S.C. § 541(c)(1)(B).

Whether or not § 541 of the Bankruptcy Act is deemed to have been incorporated into the Securities Investor Protection Act of 1970 (SIPA), 15 U.S.C. § 78aaa, et seq.,[17] it is not applicable to the case at bar.

The language of § 541(c)(1)(B) pertinent to this case is:

> . . . an *interest of the debtor in property* becomes property of the estate . . . notwithstanding any provision in an agreement . . . that is conditioned . . . on the appointment of . . . a trustee . . . , and that effects . . . a . . . *termination of the debtor's interest in property.* (Emphasis added).

The Historical and Revision Notes accompanying 11 U.S.C. § 541, and pertinent to § 541(c)(1)(B) read:

> Subsection (c) invalidates restriction on the transfer of *property of the debtor*, in order that all of the *interests of the debtor in property* will become property of the estate. The provisions invalidated are those that restrict or condition transfer of *the debtor's interest*, and those that are conditioned on the insolvency or financial condition of the debtor, on the com-

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[17] As this question was the focus of the litigation below, Amicus only treats of the new material discussed here. However, Amicus *does* support Petitioner's position.

mencement of a bankruptcy case, or on the appointment of a custodian of the debtor's property.[18]

It is a given that a fully paid insurance policy is a valid and binding contract between Petitioner and GSC, and therefore constitutes *property* of the bankruptcy estate.[19] Amicus points out that it is also a given that the only 11 U.S.C. § 541(c)(1)(B) interest of the debtor in *that* property consists of:

(1) The right to the pro rata return of the pre-paid premiums on termination for *any* reason[20] and is, by definition, payable *only* after termination, so that the interest in that property is clearly *not* terminated when the bond is terminated; and

(2) The right to the proceeds of any monies payable to GSC for cognizable claims discovered and made against the policy prior to the policy's termination also survives termination, and is payable to the trustee as soon as settlement is made after termination.

An example of the courts' typical expression on § 541(c)(1)(B) is: "Clauses which purport to terminate, limit or otherwise modify *a debtor's interest in its property* are unenforceable under the Code." *Matter of Railway Reorganization Estate, Inc.*, 133 B.R. 578, 582 (Bkrtcy. D. Del. 1991). (Emphasis added).

In the above analyses, and in the language of the statute itself, the focus is on *the debtor's interest in property.* The point is that the purpose of the statute is to prevent third parties from using contracts controlling such prop-

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[18] Notes of Committee on the Judiciary, S. Rep. 95-989, 95th Cong., 2d Sess. (1978), U.S. Code Cong. and Admin. News 1978, p. 5869. (emphasis added).

[19] *In re Cahokia Downs*, 5 B.R. 529, 531 (Bkrtcy. So.Dist.Ill. 1980).

[20] See Appendix D, page 7a, for the pertinent excerpt from National Union Fire Insurance Company of Pittsburgh, PA's Securities Dealer Blanket Bond.

erty to deny transfer of the debtor's interest in that property to the bankruptcy estate. An example of this principle is that a bankruptcy default clause in a financing agreement was found void so that the lender could not repossess a debtor's automobile and, therefore, prevent the debtor's interest in the car from becoming property of the estate where the payments and insurance were current. *In re Winters*, 69 B.R. 145 (Bkrtcy. D.Ore. 1986).

Similarly, in *In re Mitchell*, 85 B.R. 564 (Bkrtcy. D.Nev. 1988), the court examined a clause in a retail installment contract for the purchase of a car providing that, in the event of bankruptcy, the secured creditor could accelerate the unpaid balance and repossess the car. The court held that, under 11 U.S.C. § 541(c)(1)(B), such a clause could not prevent the debtor's interest in the car from becoming property of the debtor's estate. *Id.* at 566. Likewise, in *In re Jeanes Mechanical Contractors, Inc.*, 32 B.R. 657 (Bkrtcy. W.D.Ky. 1983), the court was faced with a forfeiture clause in a construction contract that gave a surety, as subrogee, the right to take possession of supplies in the subcontractor/debtor's possession in the event that the subcontractor/debtor filed for bankruptcy. The court held such forfeiture clause unenforceable under 11 U.S.C. § 541(c)(1)(B). *Id.* at 659.[21]

An obvious distinction between the above cited cases and the case at bar is that, in the cited cases, third parties were attempting to deprive the various debtors' estates of the respective debtors' interests in property (i.e., cars and materials) whereas, in the present case, the termination of the bond does not effect or attempt to effect a deprivation of property from the debtor's estate.

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[21] For additional examples of this principle, see *Matter of Lawson*, 67 B.R. 94 (Bkrtcy. M.D. Fla. 1986); *Matter of Railway Reorganization Estate, Inc., supra*; *In re Mumpfield*, 140 B.R. 578 (Bkrtcy. M.D. Ala. 1991).

As demonstrated, the interest of the debtor in this case is 1) the return of the unearned premium and 2) the right to payment for cognizable claims discovered prior to the policy's termination, that is, the property is separate and distinct from the interest in the property. These interests are not affected by the termination of the bond but survive that event, thus clearly and categorically becoming an unfettered and full part of the debtor's estate.

An additional distinction between the contract at issue here and those at which § 541(c)(1)(B) is directly aimed is that there is no third party to the GSC bond. The debtor itself is the owner of the bond. Hence, termination of the bond cannot transfer any of the debtor's interests in property to anyone other than the Trustee.

Accordingly, no interest of GSC in property is terminated upon bond termination, and 11 U.S.C. § 541(c)(1)(B) has no application to the facts of this case, thereby rendering 12(c) immune to nullification based on that statute.

Consequently, a liquidating trustee concerned only with collecting the debtor's interests in property loses no interest in property on the termination of a debtor's Form 14 financial institution fidelity bond.

In the alternative, if the Trustee/Appellee maintains that the interest transferred pursuant to § 541(c)(1)(B) was solely GSC's interest in the fidelity bond itself, which has been shown not to be the case, then that claim must also fail.

In order for the Trustee to collect an asset, the failed institution must have it as an asset. Here, GSC did not own as an asset a fidelity bond without a Sec. 12(c) immediate termination clause. Hence, the only asset transferrable is GSC's interest in a terminated bond. *See Conner*, 973 F.2d 1236, 1243, discussed, *infra*.

B. As a Congress-Created Insurer,[22] Neither SIPC Nor Its Appointed Liquidator Can Override the Termination Provisions Of A Financial Institution's Fidelity Bond.

Over the years, Congress has created insurers to protect the public against the failure of financial institutions. It created the Federal Savings and Loan Insurance Corporation (FSLIC)[23] to protect savings and loan association's customers; the Federal Deposit Insurance Corporation (FDIC)[24] to protect bank customers; and the SIPC[25] to protect the customers of stockbrokers and securities dealers. All three corporations were given substantially similar powers and goals.

All three categories of insured financial institutions are required to protect themselves against employee dishonesty through commercially underwritten fidelity bonds, substantially similar to the bond at issue here.

Considering that homogenous background, it is imminently reasonable to assume that when Congress approved the immediate termination language in the FDIC context, it also approved the identical language in the SIPC context.

The principal issue in *Conner* was whether, after taking over a failed bank, the FDIC could override a regulatory

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[22] SIPC is an insurer with limited coverage. It cannot guarantee that customers will recover their investments; investment securities deposited with brokers constantly fluctuate in value. Nevertheless, SIPC was intended to provide protection for brokerage house customers who left cash or securities on deposit, similar to the protection afforded bank depositors by the FDIC. *Securities & Exchange Commission v. Albert & Maguire Securities Co., Inc.*, 560 F.2d 569 (3rd Cir. 1977). See also *Massachusetts Financial Services, Inc. v. SIPC*, 411 F. Supp. 411 (D.C. Mass. 1976), aff'd 545 F.2d 754 (1st Cir. 1976), *cert. den.*, 431 U.S. 904, 97 S. Ct. 1696, 52 L.Ed.2d 388 (1977).

[23] 12 U.S.C. § 1724 (1934).

[24] 12 U.S.C. § 1811 (1950).

[25] 15 U.S.C. § 78ccc (1970).

exclusion in the bank's D & O Liability Insurance Policy thereby making the insurer liable for the FDIC's claims against the D & O policy.

In rejecting the FDIC's claims and affirming the District Court's grant of summary judgment in favor of the insurer, the court noted: "[T]he FDIC overlooks the very important fact that in order to marshall and collect an asset, the failed bank must have it as an asset. Here, the bank did not own as an asset directors' and officers' liability insurance without an FDIC endorsement. Therefore, such argument fails." 973 F.2d at 1243.

Addressing the legislative history of 12 U.S.C. § 1821 (e) (12) (A), the court observed that:

> Congress rejected the FDIC's proposed language and opted for the following:
>
> > "The conservator or receiver may enforce any contract, *other than a director's or officer's liability insurance contract or a depository institution bond*, entered into by the depository institution notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of, solvency or the appointment of a conservator or receiver."

Conner, 973 F.2d at 1242 (Court's emphasis); 12 U.S.C. § 1821(e) (12) (A) (1989).

Amicus further suggests that in using the broad language quoted above in § 1821(e) (12) (A), Congress announced an overwhelming and controlling public policy favoring the immediate termination clause. This same policy should apply to all Congress-created insurers, including SIPC.

C. The FDIC, Secretary of the Treasury and Attorney General Recognize That 12 U.S.C. § 1821(e)(12)(A) Prevents a Receiver or Conservator From Nullifying the Immediate Termination Provision of a Financial Institution Bond.

§ 220(b)(3) of FIRREA, enacted August 9, 1989, required the FDIC, the Secretary of the Treasury, and the Attorney General to conduct a comprehensive study of D&O insurance and depository institution bonds. A Report of that study was completed September 13, 1991.[26]

The Report recognized that, under current statutory and case law, the immediate termination provisions of financial institution bonds will be enforced.[27] This Report, as it applies to financial institution bonds, essentially repeats the same arguments that the FDIC made to Congress when it was considering FIRREA. Those arguments were rejected by Congress and by *Conner*. See Point I(B), *supra*.

This Report fully supports Amicus' view that, under current law, the 11th Circuit's holding totally ignores both the true nature of the interest in property at stake in this litigation, and the fact that the failure of 11 U.S.C. § 541(c)(1)(B) to address the 12(c) concept at all, and FIRREA's § 1821(e)(12)(A) providing that a conservator or receiver may enforce any contract other than a D & O liability insurance contract or a depository institution bond, sets down the overwhelming public policy favoring the immediate termination clause. Paraphrasing *Conner*, 973 F.2d 1242, Amicus urges that the 11th Circuit's effort to create insurance coverage where there

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[26] See Appendix I, page 22a, Excerpt from FDIC Report, Section I(A)-(C), pp. 1-3.

[27] The FDIC cites as its authority for this statement the case of *FDIC v. Aetna Casualty & Surety Co.*, 903 F.2d 1073 (6th Cir. 1990), which held that termination provisions almost identical to Sections 12 and 13 of the Blanket Bond in this case were enforceable and not against public policy.

is none should be rejected and SIPC should be referred to Congress: the only proper way to change the law is by specific Congressional action, and not by judicial decree.

D. The Accepted Principles of Statutory Construction Support a Reversal of the Lower Court's Holdings.

In construing a statute in a case of first impression, the court must first look to the plain language of the statute itself. Only if the statute is ambiguous should the court consider the legislative history. *Cabalceta v. Standard Fruit Co.*, 883 F.2d 1553, 1559 (11th Cir. 1989). See also: *U.S. v. Dadaian*, 818 F.2d 1443, 1448 (9th Cir. 1987), *mod. on reh.* 856 F.2d 1391; *Alacare Home Health Services, Inc. v. Sullivan*, 891 F.2d 850, 856 (11th Cir. 1990).

As pointed out in Section A, *supra* at page 8, 11 U.S.C. § 541(c)(1)(B) states in plain, unambiguous language that it applies only to a contract provision "that effects . . . a . . . termination of the debtor's interest in property." Since the immediate termination of GSC's fidelity bond did not terminate any GSC interest in property, the statute does not apply in this case.

The 11th Circuit's holding nullifying the immediate termination clause directly conflicts with congressional policy upholding the immediate termination clause, as evidenced by 12 U.S.C. § 1821.

The construction rule in such conflict cases is: To the extent that statutes can be harmonized, they should be, and in case of an irreconcilable inconsistency, the later and more specific statute usually controls the earlier and more general. *Hellon & Associates v. Phoenix Resort Corp.*, 958 F.2d 295, 297 (9th Cir. 1992).

Following that rule, 12 U.S.C. § 1821(e)(12)(A), passed in 1989, should prevail over 11 U.S.C. § 541(c)(1)(B), passed in 1978 and most recently amended in 1984.

POINT II

MAKING FINANCIAL INSTITUTIONS' D & O POLICIES AND FIDELITY BONDS ALSO COVER THE FINANCIAL FAILURE OF THEIR INSUREDS BY NULLIFYING SELECTED PROVISIONS OF SUCH CONTRACTS CAN ONLY MAGNIFY THE ADVERSE ECONOMIC EFFECTS OF THOSE FAILURES.

If coverage for failure of financial institutions, in the large amounts required by the risk, had been obtainable from commercial insurers at an affordable price, then Congress would not have had to create the FSLIC, FDIC, and SIPC.

Therefore, if the current efforts to indirectly transform D & O policies and fidelity bonds into co-insurance or excess insurance for the Congress-created insurers are successful, then the availability of those D & O policies and financial institution bonds will be diminished to a large extent, if indeed they do not vanish from the marketplace altogether.[28]

The court in *Conner* reported on the concern of Congress in that regard as pertains to D & O policies as follows:

> Concerned that refusing to permit regulatory and insured v. insured exclusions might eliminate the market for D & O coverage for financial institutions, Congress commissioned a comprehensive study which consisted of written submissions from numerous insurers, banking and insurance industry representatives, and others. See Brief of Appellee and Cross-Appellee Fidelity and Deposit Co. of Md. at 36-37,

[28] The Amicus membership as a whole considers that provision to be a critical component of all financial institution bonds, without which it would be logical that these companies might adopt a more conservative underwriting posture to protect their individual economic interests. See Appendix G, page 14a, January 19, 1990 Letter From Continental Insurance Company to FDIC Responding to FDIC Inquiry.

> *FDIC v. Conner*, No. 91-2782 (5th Cir. filed Dec. 18, 1991) ["F & D Brief"]. These submissions—see, e.g., Plaintiff's Exhibits 5 & 6—indicate concern that refusing to permit regulatory and insured v. insured exclusions would result in a market with few or no providers and little or no affordable coverage.

973 F.2d at 1242, fn. 16.[20]

The fidelity bond market was also surveyed at the same time that the D & O study was made and the response was substantially similar to that reported to Congress for the D & O policy market, to the effect that long-term loss of coverage would result. Clearly, such an outcome would far outweigh any short-term funds the government might receive from litigation, as in the case at bar.

Conner cautions against a judicial rewriting of insurance policies, even where the public interest might seem to be served, and quotes the Supreme Court as follows:

> "The general rule is that competent persons shall have the utmost liberty of contract and that their agreements voluntarily and fairly made shall be held valid and enforced in the courts." *Twin City Pipe Line v. Harding Glass*, 283 U.S. 353, 356, 51 S.Ct. 476, 477, 75 L.Ed. 1112 (1931).

973 F.2d at 1241.

And, although contracts may be voided on grounds of public policy: "Public policy is to be ascertained by reference to the laws and legal precedents and not from general consideration of supposed public interests." *Id.* at 1241, quoting *Muschany v. United States*, 324 U.S. 49, 66, 65 S.Ct. 442, 451, 89 L.Ed. 744 (1945).

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[20] Although the *Conner* court was only concerned with D & O policies, the report also addresses similar concerns as to financial institution bonds.

CONCLUSION

This litigation is the quintessential example of the federal regulator's continuing and dogged attempt to make inappropriate use of insurance contracts, to the point of causing their breach, as a way to produce funds to hold the government harmless from the dual crises in the banking and securities industries which the insurance industry did nothing to create and to which its policies and bonds are not answerable, precisely because those contracts expressly provide for regulatory exclusions and/or provisions terminating coverage upon the occurrence of a government takeover. These efforts, if successful, will ultimately be self defeating in that they will eliminate the very coverages which the government seeks to exploit. Accordingly, SIPC's effort to create insurance coverage where there clearly is none should be rejected. Also involved here are important concepts of breach of contract and unconstitutional takings by the government which it should not be necessary for this Court to reach because of the dispositive nature of the arguments set forth by Amicus herein.

The Petition for Writ of Certiorari should be granted and in due course the judgment of the 11th Circuit Court of Appeals should be reversed.

Respectfully submitted,

Of Counsel:
ROBIN V. WELDY
THE SURETY ASSOCIATION OF AMERICA
100 Wood Avenue South
Iselin, New Jersey 08830

Date: January 13, 1993

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APPENDICES

APPENDIX A

THE SURETY ASSOCIATION OF AMERICA

CAUSE OF LOSS EXPERIENCE STATEMENT
FOR COMBINED COVERAGE BLANKET FIDELITY BONDS
(Stated as percentages of Direct Losses Incurred)

ALL COMPANIES—COUNTRYWIDE—CALENDAR YEAR 1990

	Comm'l Banks	Savings Banks	S & L Assns	Inv. Bankers Stockbrokers Finance Cos.	All Other Financial Institutions	Forms 25 25L and 26
Fidelity Insuring Agreement—						
Dishonesty of Regular Employees	82.4%	66.5%	66.7%	92.6%	46.4%	96.5%
EDP Organizations (cov'd as empl's)	0.0	0.0	0.3	0.2	0.0	0.0
All other cov'd under Fid Ins Agrmt	1.9	8.2	3.4	0.4	17.6	0.4
On Premises Insuring Agreement—						
Misplacement	0.2	0.0	1.8	1.0	0.0	0.0
Burglary	1.0	0.8	0.4	0.9	1.1	0.0
Robbery/Hold-up	0.9	20.1	16.9	0.4	4.2	0.0
All other cov'd under On Prem Ins Agrmt	2.2	1.2	8.1	0.7	11.6	0.0
Intransit Insuring Agreement—						
Misplacement	0.1	0.0	0.0	0.1	0.0	0.0
Robbery/Hold-up	0.0	0.0	0.0	0.6	0.7	0.0
All other cov'd under In Trans Ins Agrmt	0.8	0.1	0.1	0.0	0.0	0.0
Forgery (Not By Empl) Ins Agrmts—						
All cov'd under Forg Ins Agrmts D & E	9.5	1.9	2.1	1.9	8.6	1.5
All Other—						
All other not otherwise classified	1.0	1.2	0.2	1.2	9.8	1.6
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

APPENDIX B

STATUTORY PROVISIONS INVOLVED

11 U.S.C. § 541(c)(1)(B) 1978

§ 541. Property of the estate.

(c)(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

* * * *

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

12 U.S.C. § 1821(e)(12)(A) 1989

(12) Authority to enforce contracts

(A) In general

The conservator or receiver may enforce any contract, other than a director's or officer's liability insurance contract or a depository institution bond, entered into by the depository institution notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of, insolvency or the appointment of a conservator or receiver.

APPENDIX C

EXCERPT FROM FIDELITY AN DEPOSIT COMPANY OF MARYLAND BROKER'S BLANKET BOND

Standard Form 14 Revised
(Adopted July 2, 1936)
(Not a Part of the Record)

In consideration of an annual premium, the FIDELITY AND DEPOSIT COMPANY OF MARYLAND, hereinafter referred to as Underwriter, hereby undertakes and agrees to indemnify _____ _____, hereinafter referred to as the Insured and hold it harmless, to an amount not exceeding _____Dollars ($_____), from and against any losses sustained by the Insured subsequent to noon of the date hereof and while this bond is in force and discovered by the Insured subsequent to noon of the date hereof, and prior to the expiration of twelve months after the termination or cancelation of this bend as an entirety as provided in the first paragraph of Condition 11 or in any other manner.

* * * *

4. The Insured shall give to the Underwriter written notice of any loss hereunder as soon as possible after the Insured shall learn of such loss, and within ninety days after learning of such loss shall file with the Underwriter an itemized proof of claim duly sworn to. The Underwriter shall have thirty (30) days after notice and proof of loss within which to investigate the claim, but where the loss is clear and undisputed, settlement shall be made within forty-eight hours; and this shall apply notwithstanding the loss is made up wholly or in part of securities of which duplicates may be obtained.

* * * *

11. This bond shall be deemed terminated or canceled as an entirety—*(a)* thirty days after the receipt by the Insured of a written notice from the Underwriter of its desire to terminate or cancel this bond, or *(b)* immediately upon the receipt by the Underwriter of a written request from the Insured to terminate or cancel this bond, or *(c)* immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials, or *(d)* immediately upon the taking over of the Insured by another institution. The Underwriter shall, on request, refund to the Insured the unearned premium computed pro rata if this bond be terminated or canceled or reduced by notice from, or at the instance of, the Underwriter, or if terminated or canceled as provided in subdivision *(c)* or *(d)* of this paragraph. The Underwriter shall refund to the Insured the unearned premium computed at short rates if this bond be terminated or canceled or reduced by notice from, or at the instance of, the Insured.

This bond shall be deemed terminated or canceled as to any Employee—*(a)* as soon as the Insured shall learn of any dishonest or fraudulent act on the part of such Employee, without prejudice to the loss of any Property then in transit in the custody of such Employee, or *(b)* fifteen days after the receipt by the Insured of a written notice from the Underwriter of its desire to terminate or cancel this bond as to such Employee.

APPENDIX D

EXCERPTS FROM
NATIONAL UNION FIRE INSURANCE
COMPANY OF PITTSBURGH, PA.'S
SECURITIES DEALER BLANKET BOND
(Issue Date: January 29, 1987)
(Which Forms a Part of the Court Record)

I. *PREAMBLE TO INSURING AGREEMENTS*:

"SECURITIES DEALER BLANKET BOND

"The Underwriter, in consideration of an agreed premium, and subject to the Declarations made a part hereof, the General Agreements, Conditions and Limitations and other terms of this bond, agrees with the Insured, in accordance with the Insuring Agreements hereof to which an amount of insurance is applicable as set forth in Item 4 of the Declarations and with respect to loss sustained by the Insured at any time but discovered during the Bond Period, to indemnify and hold harmless the Insured for:"

* * * *

II. *BOND DEFINITION OF "PROPERTY"*:

DEFINITIONS

"Section 1. The following terms, as used in this bond, shall have the respective meanings stated in this Section:

"(b) 'Property' means money (i.e., currency, coin, bank notes, Federal Reserve notes), postage and revenue stamps, U.S. Savings Stamps, bullion, precious metals of all kinds and in any form and articles made therefrom, jewelry, watches, necklaces, bracelets, gems, precious and semi-precious stones, bonds, securities, evidences of debts, debentures, scrip, certificates, interim receipts, warrants, rights, puts, calls, straddles, spreads, trans-

fers, coupons, drafts, bills of exchange, acceptances, notes, checks, withdrawal orders, money orders, warehouse receipts, bills of lading, conditional sales contracts, abstracts of title, insurance policies, deeds, mortgages under real estate and/or chattels and upon interests therein, and assignments of such policies, mortgages and instruments, and other valuable papers, including books of account and other records used by the Insured in the conduct of its business, and all other instruments similar to or in the nature of the foregoing including Electronic Representations of such instruments enumerated above (but excluding all data processing records) in which the Insured has an interest or in which the Insured acquired or should have acquired an interest by reason of a predecessor's declared financial condition at the time of the Insured's consolidation or merger with, or purchase of the principal assets of, such predecessor or which are held by the Insured for any purpose or in any capacity and whether so held by the Insured for any purpose or in any capacity and whether so held gratuitously or not and whether or not the Insured is liable therefor."

III. *DISCOVERY OF LOSS AND WHEN DISCOVERY OCCURS*:

"LOSS—NOTICE—PROOF—LEGAL PROCEEDINGS

"Section 4 . . . "At the earliest practicable moment after discovery of any loss hereunder the Insured shall give the Underwriter written notice thereof. . ."

"Discovery occurs when the Insured becomes aware of facts which would cause a reasonable person to assume that a loss covered by the bond has been or will be incurred even though the exact amount or details of loss may not be then known. Notice to the Insured of an actual or potential claim by a third party which alleges that the Insured is liable under circumstances, which if

true, would create a loss under this bond constitutes such discovery."

IV *BOND TERMINATION LANGUAGE*:

"Section 12. This bond shall be deemed terminated or canceled as an entirety:

(a) sixty days after the receipt by the Insured of a written notice from the Underwriter of its desire to terminate or cancel this bond, or

(b) immediately upon the receipt by the Underwriter of a written request from the Insured to terminate or cancel this bond, or

(c) immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials, or

(d) immediately upon the taking over of the Insured by another business entity, or

(e) If the Insured is a Registered Management Investment Company covered as a sole Insured, this bond shall not be canceled, terminated or modified except after written notice shall have been given by the acting party to affected party, and to the Securities and Exchange Commission, Washington, D.C., not less than sixty days prior to the effective date of such cancellation, termination or modification.

The Underwriter shall, on request, refund to the Insured the unearned premium, computed pro rata, if this bond be terminated or canceled or reduced by notice from, or at the instance of, the Underwriter, or if terminated or canceled as provided in sub-section (c) or (d) of this paragraph. The Underwriter shall refund to the Insured the unearned premium computed at short rates if this bond be terminated or canceled or reduced by notice from, or at the instance of, the Insured.

* * * *

APPENDIX E

EXCERPTS FROM SURETY ASSOCIATION OF AMERICA'S FINANCIAL INSTITUTION BOND

Standard Form 14

(Revised to October, 1987)

(Not a Part of the Record)

The Underwriter, in consideration of an agreed premium, and in reliance upon all statements made and information furnished to the Underwriter by the Insured in applying for this bond, and subject to the Declarations, Insuring Agreements, General Agreements, Conditions and Limitations and other terms hereof, agrees to indemnify the Insured for:

* * * *

(o) Property means Money, Certificated Securities, Uncertificated Securities of any Federal Reserve Bank of the United States, Negotiable Instruments, Certificates of Deposit, documents of title, Acceptances, Evidences of Debt, security agreements, Withdrawal Orders, certificates of origin or title, Letters of Credit, insurance policies, abstracts of title, deeds and mortgages on real estate, revenue and other stamps, tokens, unsold state lottery tickets, books of account and other records whether recorded in writing or electronically, gems, jewelry, precious metals of all kinds and in any form, and tangible items of personal property which are not hereinbefore enumerated.

* * * *

DISCOVERY

Section 3. This bond applies to loss discovered by the Insured during the Bond Period. Discovery occurs when the Insured first becomes aware of facts which would cause a reasonable person to assume that

a loss of a type covered by this bond has been or will be incurred, regardless of when the act or acts causing or contributing to such loss occurred, even though the exact amount or details of loss may not then be known.

Discovery also occurs when the Insured receives notice of an actual or potential claim in which it is alleged that the Insured is liable to a third party under circumstances which, if true, would constitute a loss under this bond.

* * * *

TERMINATION OR CANCELATION

Section 12. This bond terminates as an entirety upon occurrence of any of the following:—(a) 60 days after the receipt by the Insured of a written notice from the Underwriter of its desire to cancel this bond, or (b) immediately upon the receipt by the Underwriter of a written notice from the Insured of its desire to cancel this bond, or (c) immediately upon the taking over of the Insured by a receiver or other liquidator or by State or Federal officials, or (d) immediately upon the taking over of the Insured by another institution, or (e) immediately upon exhaustion of the Aggregate Limit of Liability, or (f) immediately upon expiration of the Bond Period as set forth in Item 2 of the Declarations.

This bond terminates as to any Employee or any partner, officer or employee of any Processor—(a) as soon as any Insured, or any director or officer not in collusion with such person, learns of any dishonest or fraudulent act committed by such person at any time, whether in the employment of the Insured or otherwise, whether or not of the type covered under Insuring Agreement (A), against the Insured or any other person or entity, without prejudice to the loss of any

Property then in transit in the custody of such person, or (b) 15 days after the receipt by the Insured of a written notice from the Underwriter of its desire to cancel this bond as to such person.

Termination of the bond as to any Insured terminates liability for any loss sustained by such Insured which is discovered after the effective date of such termination.

APPENDIX F

PAGES 28 AND 29 FROM BRIEF OF APPELLEE SECURITIES INVESTOR PROTECTION CORPORATION (DATED DECEMBER 10, 1992) IN THE MATTER STYLED *IN RE WADDELL JENMAR SECURITIES, INC. v. NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA.* UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
Docket No: 92-2158

(Not Part of the Record)

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* * * *

In the present case, "employee" is unambiguously defined in the bond. NUFIC drew the agreement and NUFIC defined the term. Even if the term were ambiguous, the ambiguity would have been resolved in favor of the insured.

NUFIC relies upon *General Finance Corp. v. Fidelity & Casualty Co. of N.Y.*, 311 F.Supp. 353 (D.S.D. 1970), for the proposition that "the owner of an interest in an insured corporation is not included in the term 'employees' covered by a fidelity bond." (Appellant's brief, p. 14). However, NUFIC fails to inform this court that the Eighth Circuit *reversed* the district court *on this very issue* and found liability on the fidelity bond for the fraud and theft of the president and majority shareholder of the insured corporation. *General Finance Corp. v. Fidelity Casualty Co., of N.Y.*, 439 F.2d 981 (8th Cir. 1971). Accordingly, NUFIC's reliance upon *General Finance* for the proposition that the owner of a controlling interest in the insured cannot be a covered employee under a fidelity bond is misplaced and simply wrong.

NUFIC's attempt to imply that the bond contains a sweeping exclusion of all persons who controlled the corporation should also fail on public policy grounds. Were

the court to adopt NUFIC's argument, *all* principals in any corporation would be potentially excluded from the coverage of fidelity bonds. NUFIC is one of the principal underwriters of this coverage in the fidelity bond market and profits from the sale of these policies. Many insureds in this market are small corporations or wholly owned businesses. Thus, these corporations and their customers would be virtually unprotected against theft by corporate principals. The bond coverage would be a nullity as to any corporate principal even though the bonding company did not specifically contract for such sweeping limitation.

Furthermore, the public policy underlying the requirement that broker-dealers such as WJS obtain fidelity bonds runs counter to NUFIC's argument. A broker-dealer such as WJS is required to register with the Securities and Exchange Commission (the "Commission") under section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act.").[11] Such a registered broker-dealer must comply with the Commission's net capital rule.[12] The National Association of Securities Dealers ("NASD") was the self-regulatory organization with jurisdiction over WJS. The NASD requires all broker-dealers to carry fidelity bonds tied to the net capital rule requirement. Simply put, the net capital rule prescribes a test that ensures that registered broker-dealers have adequate liquid assets to meet their obligations to their investors and creditors, and its primary purpose is to protect the customers and creditors of registered broker-dealers from monetary losses that can occur when such a broker-dealer fails.[13] Thus, the requirement that a broker-dealer obtain a fidelity bond is meant to protect a broker-dealer's customers.

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[11] 15 U.S.C. § 78o(b) (1988 & Supp. II 1990).

[12] Exchange Act Rule 15c3-1, 17 C.F.R. § 240.15c3-1 (1991).

[13] *See* Jamroz, "The Net Capital Rule", 47 The Business Lawyer 863 (1992); Net Capital Rule, Exchange Act Release No. 27,249, [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,501 (Sept. 15, 1989).

This public policy argument is supported in the case of *Foster v. NUFIC*, 902 F.2d 1316 (8th Cir. 1990). In that case, investors brought an action against NUFIC seeking to recover under a broker-dealer's fidelity bond for losses caused by the fraudulent and dishonest acts of the firm's owner. The investors had sought, but were denied SIPC protection.[14] In affirming the district court's order in favor of the investors, the 8th Circuit held that "[t]he fidelity bond was one statutorily required and should be liberally interpreted to carry out the purposes of the statute, the protetcion of the investing public." *Id.* at 1320.

* * * *

[14] The investors were not deemed to be "customers" under SIPA entitled to SIPC protection because they had not deposited their funds with the failed broker-dealer for the purpose of purchasing securities, but rather had loaned their money to the broker-dealer's owner. Nonetheless, after a jury trial in Arkansas, it was found that the investor's losses were due to the fraudulent and dishonest acts of the owner.

APPENDIX G

JANUARY 19, 1990 LETTER FROM CONTINENTAL INSURANCE COMPANY TO FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC) RESPONDING TO FDIC INQUIRY

(Not Part of the Record)

CONTINENTAL
INSURANCE

Continental Guaranty
& Credit Corporation
180 Maiden Lane
New York, NY 10038

January 19, 1990

Mr. M. Lauck Walton, Counsel
Federal Deposit Insurance Corporation
550 17th Street, N.W., Room 4018
Washington, D.C. 20429

Re: FIRRERA STUDY

Dear Mr. Walton:

It is evident that no single information source exists which would provide reliable data along the lines as requested by the FDIC. As such, it is impossible to accumulate any statistics within Continental (or within the industry according to the Surety Association of America) to document the element of risk in continuing coverage on a Financial Institution Bond after the bank is placed under regulatory control.

In our experience the risk of claims activity is materially increased in the event the bond term is extended to provide coverage, or a loss discovery period to regulatory authorities. If nothing else, loss adjustment expense becomes a very significant loss contributor as diligent regulators seek to protect the public's funds. While we don't

keep figures segregating these costs of losses paid to regulators, I can tell you that such claims were a substantial contributor to my company's unsatisfactory results from financial institutions bond underwriting in the early 1980's.

The bond is a contract between the financial institution and the insurance company. The institution responds to requests for underwriting data (warranting its accuracy), and an insurer structures the contract and pricing for the product. A fundamental issue is the contractual relationship between the parties; no independent third party has direct right of recovery under a standard bond. The exclusion of coverage for change of control, or ownership is well documented. The exclusion for regulatory control has existed for over sixty years in the bond form.

We provide bonds for banks ranging from the largest institutions in the country to the small community banks. While underwriting issues vary according to size of the institution, one underlying judgment is always present. We provide bonds for clients who are considered to be effectively managed businesses which are financially sound.

This judgment is influenced by Section 12 of the SAA Bond form which states that coverages are terminated "immediately upon the taking over of the insured by a receiver or other liquidator or by State or Federal officials. . . . . ".

If this condition is removed, or modified to extend a discovery period to such individuals, it is certain that our company, and possibly others, will adopt a more conservative underwriting posture.

This may severely restrict the availability and affordability of bonding to the very class of institution who can least afford to expose their own surplus to perils covered by the bond. In these cases, uncovered claims could ac-

celerate financial deterioration and the need for public ballouts and regulatory involvement.

/s/ Michael J. Beernaert
MICHAEL J. BEERNAERT
Executive Vice President

WRT/pg

cc: Beverley Wadsworth
William Gibson
Martin Haber
Wesley Tucker
Betsy Headd
John Urbanik
Jay Edenfield
Lloyd Provost
Francis LeMunyon

APPENDIX H

DECEMBER 17, 1982 NASD MEMORANDUM TO ALL MEMBERS ANNOUNCING GROUP FIDELITY BOND BUYING PROGRAM
(Not a Part of the Record)

Notices to Members should be retained for future reference.

NASD

National Association of
Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20008
(202) 728-8000

December 17, 1982

MEMORANDUM

TO: All NASD Members

RE: *GROUP FIDELITY BOND BUYING PROGRAM*

It gives me a great deal of pleasure to announce that the NADS sponsored program to provide fidelity bonds for NASD members will commence immediately. It will be underwritten by the National Union Fire Insurance Company of Pittsburgh, Pennsylvania, a member of the American International Group of Insurance Companies and administered by Marsh & McLennan Inc.

The program will be of significant benefit to most NASD members who are required to carry fidelity bonds. It will provide competitive premium rates and easy access to fidelity bonding coverage up to $500,000.

Here are some of the highlights of the program:

1) Members whose minimum fidelity bonding requirement is $500,000 or less will be eligible to participate in the program.

2) Members who wish to purchase more than their minimum required coverage may do so within the program, up to $500,000.

3) In most cases bonds will be issued without underwriting on receipt of a simple application and a check for the first annual premium. In most situations members will be able to calculate their own premiums as indicated in the attached material.

4) The amount of coverage purchased will apply to all insuring agreements. These will be no reduction in coverage for Securities Forgery or Fraudulent Trading.

5) There will be two deductible levels as follows:

Amount of Coverage	*Deductible*
Up to $250,000	$ 5,000
$250,000 to $500,000	$10,000

6) Members who do not generally carry customer accounts (i.e. those subject to paragraph (a)(2) of the SEC's net capital rule 15c3-1) will receive a 10% discount from the basic premium.

Definition of Employee

In Notice to Members No. 82-40, dated June 17, 1982, the Board of Governors of the Association asked for member comments on a proposed amendment to the NASD fidelity bonding rule which would add a definition of employee to the rule. After careful consideration of the comment letters received, the Board unanimously approved the amendment at its meeting on July 16, 1982. The amendment was filed with the Securities and Exchange Commission pursuant to Rule 19b-4 under the Securities Exchange Act of 1934. Commission approval of the amendment was received on December 1, 1982.

Text of the Amendment to Article III, Section 32
NASD Rules of Fair Practice

The following is the full text of new paragraph (e) to Appendix C of Article II, Setcion 32 of the NASD Rules of Fair Practice:

Definitions

(e) For purposes of fidelity bonding the term "employee" or "employees" shall include any person or person associated with a member firm (as defined in Article I, Section 3(f) of the By-Laws(except:

1) Sole Proprietors

2) Sole Stockholders

3) Directors or Trustees of member firms who are not performing acts coming within the scope of the usual duties of an officer or employee.

Effect of the Amendment

The amendment will require members to include under their fidelity bonding coverage most persons associated with their firms who are engaged in the investment banking or securities business.

Co-owners (partners and partial stockholders), officers, employees and registered principals and representatives will be required to be covered under members' fidelity bonds.

Persons associated with member firms who are sole owners (sole proprietors and sole stockohlders) will not be classified as employees and will not be required to be included under their firm's coverage. Such will also be true of Directors and Trustees of member firms who do not engage in activities on behalf of their firms which fall within the scope of the usual duties of officers or employees.

The definition of employee in the policy to be used in the group program has been amended to comply with the new definition of employee. Members who are not eligible for or who do not choose to join the group program will be required to bring their current bonds into compliance with the new definition of employee.

Grace Period

To provide members with sufficient time to bring their bonds into compliance either by joining the group program or by having their current bonds amended, a grace period of 12 months from December 17, 1982 will be allowed to all NASD members.

Enhancements to the Group Program

As soon as the Group Fidelity Bond Program is underway other coverages desired by members will be evaluated by the Fidelity Bonding Committee and offered to members. The first such coverage will be the Surety Bonds required by many State Blue Sky Laws.

Participation

The policy and rates are currently being filed in all states. Most states have file-and-use regulations but there are some whose regulations require specific approval. *If there is no informational material enclosed with this letter the policy and rates are not yet approved in your state.* As soon as such approval is received you will receive the necessary information to enable you to join the program.

The key to the success of any group insurance program is maximum participation by those who are eligible to joint such a plan. I urge those of you who are eligible to participate to do so either immediately or as soon as it is to your economic advantage.

Questions about the operation of the program, e.g., rates, coverage, applications, claims, etc. should be di-

rected to March & McLennan Inc. Location and phone numbers are in the enclosed informational material.

Questions relating to the fidelity bonding and the new definition of employee should be directed to A. John Taylor, Vice President, Variable Contracts at (202) 728-8328.

Sincerely,
GORDON S. MACKLIN
President

APPENDIX I

EXCERPTS FROM FDIC REPORT: REPORT ON DIRECTORS' AND OFFICERS' LIABILITY INSURANCE AND DEPOSITORY INSTITUTION BONDS PURSUANT TO SECTION 220(b)(3) OF THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT OF 1989, DATED SEPTEMBER 13, 1991

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EXECUTIVE SUMMARY [1]

A. The Statute

The Financial Institutions Reform. Recovery, and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183, was enacted on August 9, 1989. In § 220(b)(3), the statute requires a Report on Directors' and Officers' Liability Insurance. Subsection (A) reads as follows:

> The Federal Deposit Insurance Corporation shall, together with the Secretary of the Treasury and the Attorney General, conduct a comprehensive study of directors' and officers' liability insurance and depository institution bonds, and the availability of such insurance for directors and officers of insured depository institutions. The Study shall include:
>
> (i) consideration of State Laws limiting liability for directors and officers;
>
> (ii) the effect of contractual provisions limiting insurance coverage when an institution is placed in receivership or conservatorship;

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[1] Additional views of the Treasury Department are set forth in Appendix F.

(iii) provisions limiting coverage when a claim is made by the Federal Deposit Insurance Corporation; and,

(iv) provisions limiting claims made by one insured against another insured.

In addition, the study shall consider the need for such insurance or bonds and the effect any change in any of the above noted conditions or terms may have on the future availability of such insurance, and the ability of depository institutions to attract qualified officers and directors.

B. Scope and Emphasis of the Study

The mandated study is directed to two specific lines of coverage in the broader property/casualty market, and even as to those lines, is focused on policies purchased by depository institutions. The two lines to be studied are directors' and officers' liability insurance ("D&O") and depository institution bonds ("bonds"). D&O protects directors and officers against liability arising from wrongful conduct that falls short of fraud or dishonesty.[2] The D&O policy is usually in two parts. In part I of the policy, the corporation is protected only to the extent that it indemnifies the director or officer. Under part II, the director or officer is protected directly if indemnification is not made or is impermissible. Financial institution bonds (also called blanket bonds) primarly protect the corporation from losses stemming from dishonesty by officers or employees (or directors acting as officers or employees).

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[2] Throughout this study, an attempt has been made to summarize in generic terms what parts of D&O and bond policies cover, mean, or are argued to mean by carriers, insured officials, or the FDIC. In lieu of repeating "purportedly" or "in the view of . . ." as a preface to virtually every descriptive statement, all such statements must be read as providing a general overview (not addressing specific policy language) and as efforts to summarize interested parties' views, but not as an acknowledgement that such views are correct.

The principal emphasis of the study is on D&O insurance, as the specific inquiries in the statute relate almost entirely to that line, rather than to bonds. For example, the first of those specific statutory inquiries relates to state laws limiting liability of directors and officers even though they are guilty of gross negligence, or even recklessness. *See* § 220(b)(3)(A)(i). Such provisions have no effect on the fraud coverage of bonds. Similarly, though one bond underwriter formerly attempted to limit bond coverage when a claim was made by a regulatory agency, the vast majority of bonds do not contain such a provision and no such provision is proposed by the Surety Association of America (SAA) which formulates standard bond clauses for the industry. *See* § 220(b)(3)(A)(iii). Nor is there any bond provision which seeks to limit claims by one insured against another—indeed, in a bond there is but one insured, the corporation itself. *See* § 220(b)(3)(A)(iv).

With respect to § 220(b)(3)(A)(ii), bond provisions which terminate the bond upon change of control or failure, and which eliminate a traditional provision that permits purchase of an extended period of insurance during which losses could be ascertained (extended "discovery" clauses), may have some impact on the FDIC's position in a limited number of cases, and on bond affordability. With respect to the more general inquiries posed by Congress, provisions in bonds which limit coverage, as for instance by excluding certain types of fraud, are relevant to the study only because they may affect affordability of bonds. The reduction of coverage affects their usefulness to depository institutions and may raise questions as to whether it is prudent to purchase coverage with major gaps. There is no evidence in the literature or elsewhere, however, that the availability of bonds has any effect whatsoever on the willingness of officers or directors to serve. Nevertheless, we have included an analysis of bond provisions in the report.

In sum, the study responds to Congress' specific inquiries as to D&O insurance, responds generally as to "availability," "affordability" and "need" for both D&O and bonds, and as to the effect that availability of D&O insurance has on the willingness of directors to serve.

C. Interest of the Study Agencies

The agencies designated by Congress to study this issue —(the Federal Deposit Insurance Corporation ("FDIC"), the Secretary of the Treasury, and the Attorney General) —have each either directly or indirectly taken public positions in litigation or elsewhere which bear on some or all of the issues presented.

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